Super boards on the cusp of change

by Dan Coone, Principal
Financial Services Practice
and Danielle Fraillon, Partner
Leadership Consulting Practice
Australia's superannuation funds are on the cusp of momentous change. The federal government is considering measures to increase the number of independent directors on super boards, and is promoting other measures to improve governance and increase competition. Market forces, including rapid transformation of the financial services sector via technology, as well as the growing complexity of a globalised investment landscape, are also driving renewal.

The key to success, as always, is leadership. In this paper, we explore the issues facing the funds, and explore some new solutions.

Superior governance and a supportive corporate culture are behind the success of the world's top-performing pension funds. Effective boards help to shape an environment where great talent can flourish, and where the leadership team can deliver the desired strategy.

While Australian funds have enviable assets and fund inflows in global terms, thanks to compulsory employer contributions and strong local sharemarket performance, we are arguably at a tipping point when it comes to governance.

Industry funds are facing outflow pressure from members rolling over their nest egg into self-managed super funds (SMSFs), while some for-profit funds are being criticised for high fees.

The federal government wants more independent directors on industry fund boards traditionally run by a mix of employer and union representatives, with a broad spectrum of leadership experience.

While media rhetoric may focus on ‘who’s on the board’ versus ‘who should be on the board,’ we believe the real issue is whether boards are taking a holistic view of their makeup to ensure the board structure lines up with the parameters of their mission.

Proactively, many boards in recent years have chosen directors from the ranks of corporate and investment communities to fill out their portfolio of skills.

But the scramble is now on for directors who can also help develop new ideas in a more competitive era.

In particularly high demand due to changes in the business landscape are directors with technology and
wealth management expertise, strong investment background, experience in customer-facing businesses, mergers and acquisitions, and knowledge of international investment markets.

Banks have traditionally had the edge with big budgets and comprehensive technology systems implemented over time, and an ability to bundle banking and super products into one convenient location.

But industry funds are fast catching up. They are grappling with issues such as:

- How to grow big enough to compete with banks both for distribution purposes, and to capture the benefits of scale for investments such as infrastructure assets.
- Whether to insource or outsource investment management.
- Search for yield in a low-interest rate environment.
- Data integrity.
- Building, buying or merging administrative and information technology (IT) systems and platforms.
- Expansion of lifecycle investment and post-retirement solutions – annuity versus allocated pension products, or a combination of both.

Such demands require board members and senior executives with a different set of skills and backgrounds.

The Canadian experience

Thankfully, we have seen this movie before, and we know how it ends. Canadian funds underwent a shake-up in the mid-1990s after fears they would not have enough money to provide for Boomer retirements.

Senior executives and CEOs of all major funds were recruited from the top ranks of Canadian finance, government and business. With changes in governance, senior executive teams and cultural transformation, they set themselves on a road to expansion and improved fund security.

While the road was not without its speed bumps, the foundations were strong. As former Canadian Pension Plan Investment Board (CPPIB) CEO David Denison recalls:

“The challenges were enormous. When I joined, there were only 70 staff and the investing was passive, because it was still a young organisation and they had adopted a passive and inward-looking investing approach designed for a start-up organisation.

“We changed that to a global outlook and active investing. CPPIB now has 825 people, with offices in London and Hong Kong.”

The fund grew from USD$70bn in assets, mostly invested in index funds, to an actively managed portfolio worth just
over USD$200bn today. It has investments in real estate, private companies, infrastructure from toll roads in the United Kingdom to desalination plants in Australia, as well as public company stock.

Keys to success at CPPIB were:

• An independent board of directors.
• Salaries competitive with the private sector.
• Size and scale, which enabled the fund to compete globally.

“And the greatest of these is governance,” Denison says. “I cannot stress too much how important the governance is. I was in the UK delivering a speech to the Canada-UK Business Council and the intent was to address what pension fund managers had been saying in the media – things like, ‘Wouldn’t it be wonderful if we could get UK pension plans to invest in infrastructure to help the UK just like those Canadians do in our country?’ I said it was about governance, scale and then the willingness to improve other practices to support high-performing investment management.”

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—David Denison

Overcoming the structural obstacles

The biggest danger in hiring ‘high-flying’ leaders into industry funds from the corporate or for-profit world is that differences in culture will impede success, or that their attitude to performance may be too focussed on short-term returns at the expense of longer-term security. We know of several investment banking executives who have entered the super funds sector in Australia and just as quickly departed.

One former fund CEO confided: “You need to bring in fresh blood, or the same people will simply come in each day and turn the lights on, and the malady will linger on. I was blessed with a good board and inherited an executive team with a good mix of professional funds management and investment banking. Some industry funds have a shortage of people with good commercial backgrounds – usually because of their reluctance to pay. But the time is coming when they won’t have a choice.”

In an interview with Heidrick & Struggles before his retirement from the CPPIB (he has since gone on a board career at Bell Canada Enterprises and the Royal Bank of Canada), Denison warned that poor structures and cultures would deter the best executives from joining a fund.
“I personally interviewed many people who I would say are terrific professionals in their area of activity – private equity or public market investing or real estate investing, whatever the case might be – but when we saw how they wanted to operate, I could quickly say, ‘You’re ideally suited to a different environment than the one we have here’.

“You have to have the necessary conditions for future success or you will have bad experiences and your organisation will get a bad reputation for executive churn or having sub-par performers.”

Of the changes he sees taking place here, Denison said: “It seems to me that in Australia you’ve got this nice window of opportunity to get it right.”

Ian Silk, who heads Australia’s largest super fund, AustralianSuper, says ‘the mission’ is a critical factor in recruiting senior executives: “The responsibility of ensuring the quality retirement of millions of Australians must be the over-riding concern.”

He says that to be successful, funds need “really competent people who can sort the wheat from the chaff in terms of the many, many deals that cross the super fund’s desk.”

Greater professionalism exists today in industry funds, compared with the early days. As Silk says, “the old stereotype is that profit-for-member funds were a sinecure for union officials and for-profit retail funds managed by financial whiz kids, but this has not been true for 20 years or so.”

With skillsets clearly defined, the key question is whether the leadership is aligned with the core purpose of the fund, which is to provide a retirement benefit for working Australians.

Bringing on board M&A experience

As the super industry starts to grow scale in order to take advantage of bigger investment opportunities, the issue of culture in merged entities becomes an important consideration.

We believe good governance drives performance and defines the culture, which in turn works to remove frustrations and attract talent. Industry fund trustees with an understanding of mergers and acquisitions (M&A) are becoming increasingly important as the pace of consolidation picks up.

Board members with M&A experience should scrutinise:

• **Comparative liabilities**
  Is the target fund three years away from starting to pay out to the bulk of its members, while we have eight years to go before large liabilities kick in?

• **Culture**
  How different are our people in terms of investment vision, and how will we integrate the teams?

M&A skills are not just about assessment of the financials, but integration of operations and investment philosophy. For example, one group of trustees may believe the best way to serve members is with a vanilla offering, while another may want a sophisticated menu of choice. Alignment of vision is the key.
Digital, global and available

Within a generation, some industry super funds have evolved from being simple repositories of member savings, to being sophisticated financial services institutions.

But while some large retail financial institutions have integrated product offerings backed by technology that will help to lock in customers from cradle to grave, many funds are coming late to the digital party.

Today, members open their statements to read a rear-view mirror view of their assets, with few knowing before they retire exactly how much they will have for ‘the rest of their lives.’

Jeremy Cooper, chairman of the federal government-initiated review of the superannuation industry, told us that few funds are considering ‘sequencing risks,’ a situation that takes place when a retiree may choose to step out of the workplace in a year when the sharemarket is crashing, destroying years of carefully built-up value.

The solution is to top up the fund during a down year – but this cannot be done if sequencing risk is not being measured or likely pension flows are not predicted.

Fund members are demanding digital dashboards able to display multiple accounts, scenarios, and budgeting tools.

The other critical demand is for senior executive leaders with global best-practice experience in distribution and investment, and knowledge of international markets.

While some of our larger Australian funds have ventured offshore for investment opportunities, the investment expertise to manage this growth still has plenty of room to grow.

Strategic board members with a global background will be valuable to provide oversight of these plans as offshore investments expand.

And with the increasing regulatory and compliance burden comes another mandatory requirement for directors – time.

Former Labor government Superannuation Minister Nick Sherry (now with Citi) told us that in his view, many trustees do not have the time required due to pressures of other commitments, and the increased complexities of their role.

“Obviously a board meets once a month like any large company board, but you have to have the depth of knowledge about your subject by keeping on top of trends, going to conferences, reading everything you can on the topics involved, and doing a lot of work over and above the board meetings. This would take three to four days a month.”

Sherry says he believes most boards are competent – “but they are in constant need of review if the challenges of administration and IT are to be overcome.”

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We believe that wealth management, risk and technology experience are some of the biggest gaps on our super boards, both industry and retail. These skills are particularly crucial in an era where customers can easily compare and switch funds online. We are moving rapidly towards a world where members can vanish without trace in a single click, or a swipe.
Conclusion

The Australian Prudential Regulation Authority last year (2013) amended its prudential standards and trustee director covenants to set new benchmarks for boards, including a requirement for independent board performance reviews at least every three years.

Board effectiveness reviews should look at the projected tenure of members, their length of service and skills needed to match the mission of the fund.

Other opportunities for renewal occur when mergers take place, with a commensurate reduction in the number of trustees. Natural attrition also provides a pause to examine the mix of experience and attributes.

While boards today have audit and compliance, risk and investment committees and sub-committees that may not have existed 20 years ago – and no doubt a greater depth of experience – they now need to examine the totality of the board make-up in a strategic rather than an event-driven manner.

At Heidrick & Struggles, we help boards understand the linkages between strategy, structure and culture in order to ensure they are all working in unison to accelerate the achievement of their business goals.

We do this by working with boards and top teams to design a culture that fits with the desired goals. We then assist the leaders to live the behaviours which can then be cascaded throughout the organisation.

Sustainability of this shift is delivered through a structured ‘transfer of competency’ program which enables the organisation to continually refine the culture as the needs of the organisation change.

The dynamic nature of organisational culture change is facilitated through a board development program which can include:

- A review of strategic (future state) cultural goals and assessing skills and capabilities to identify gaps (if any).
- Assisting the board to develop current directors, or working with the board to identify external directors.
- Cultural integration of new appointments to the board.

We provide a structured and evidence-based approach which ensures the future composition of the board is appropriately matched to the identified requirements.

Recruitment of additional independent directors and the appointment of employer and members directors will take place either as anticipated legislative changes come into force, or as the board decides to review and refresh its team.

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Nick Sherry
Heidrick & Struggles is the premier provider of senior-level Executive Search, Culture Shaping and Leadership Consulting services. For 60 years we have focused on quality service and built strong relationships with clients and individuals worldwide. Today, Heidrick & Struggles leadership experts operate from principal business centres globally.

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Dan Coone  
Principal, Financial Services Practice  
Heidrick & Struggles  
Level 28, Governor Phillip Tower  
1 Farrer Place  
SYDNEY NSW 2000  
+ 61 (0)2 8205 2000  
dcoone@heidrick.com

Danielle Fraillon  
Partner, Leadership Consulting Practice  
Heidrick & Struggles  
Level 35  
140 William Street  
MELBOURNE VIC 3000  
+ 61 (0)3 9012 3000  
dfraillon@heidrick.com